

EXHIBIT B

EXPERT REPORT OF JAMES K. MALERNEE, JR.

EXPERT REPORT OF JAMES K. MALERNEE, JR.

In Re: *Oscar Private Equity v. Allegiance Telecom*

I. QUALIFICATIONS

1. I am a co-founder and former CEO/President of Cornerstone Research, an economic and financial consulting firm that was started in 1989 and presently has over 400 employees in six offices around the country. I am currently Managing Director and Chairman of the Board of the firm.
2. My educational background includes a Ph.D. in Finance from the University of Texas (Austin), an MBA from Southern Methodist University, and a B.S. in Engineering from the University of Texas (Austin).
3. Prior to starting Cornerstone Research I have taught Finance at the University of Texas (Austin) and Business Strategy at the Stanford Graduate School of Business. I also worked as a registered representative in securities and commodities, and I worked as a management consultant to a number of companies where I was engaged primarily on financial and strategic issues facing my clients. Besides the Board of Directors of my own firm, I have also served on the Board of Directors of RealPage, Inc. in Carrollton, Texas, where I am now an Advisor, and I am on the Advisory Council to the McCombs School of Business at the University of Texas.

4. I have authored monographs and articles dealing with the impact of information on share price and have given presentations on the economic analysis of losses in the context of how information affects share prices at professional association meetings, such as the Financial Management Association, and at sessions offered by the Practicing Law Institute and the Business Roundtable. I have been retained as an expert on numerous securities cases over the last 20 years, many of which have had disclosure issues that were similar to the disclosure issues present in this case. I have been qualified and testified as an expert in Federal District Court concerning securities matters, but I have not testified in trial as an expert witness in the last four years.¹ A copy of my curriculum vitae is attached as Exhibit 1.
5. I was retained in this matter by counsel for Allegiance Telecom (“Allegiance” or “the Company”) and I am being compensated at my standard billing rate of \$630 per hour for my services.

II. ASSIGNMENT AND MATERIALS REVIEWED

6. In my retention I was asked by counsel for Royce J. Holland and Anthony Parella to analyze the report of Candace Preston², expert for the Plaintiffs, in light of the Fifth Circuit decision in *Oscar Private Equity v. Allegiance Telecom*, and to render an opinion about her analysis and the conclusions she had drawn.

¹ Within the last four years, I have been deposed in connection with the following matter: *In re Metris Companies Inc. Securities Litigation*, August 18, 2005.

² Second Report of Candace L. Preston, CFA in Support of Plaintiff’s Motion for Class Certification, dated 10/31/2007.

7. In undertaking this assignment, I reviewed various pleadings, the Fifth Circuit decision, reports provided by Ms. Preston, and undertook my own analysis of the factors affecting Allegiance Telecom's stock price on February 20, 2002. A complete listing of the documents I have relied upon in this matter are listed in Exhibit 2.

III. BACKGROUND AND STATEMENT OF THE PROBLEM

8. This is a class action fraud-on-the-market lawsuit filed under Rule 10b-5. Ms. Preston had filed a "Report of Candace L. Preston in Support of Plaintiff's Motion for Class Certification" dated September 21, 2004, wherein she presented an event study and opined that Allegiance Telecom had traded in an efficient market. Relying on the fraud on the market theory, the district court certified the class.
9. The Fifth Circuit vacated the certification and remanded the case.
10. On November 1, 2007, Plaintiffs filed their Supplemental Submission³, which summarized the issues that I have been asked to address:

"What the Court must now decide is whether it is more probable than not that the 12% line count restatement described in Allegiance Telecom, Inc.'s (the "Company") February 19, 2002, published report of its 4Q 2001 and 2001 year-end results, and a follow-up conference call, was the cause of a significant part of the \$1.05 price decline on February 20, 2002..."⁴

"In particular, because other information was disclosed to the market at the same time, plaintiffs were tasked with submitting 'some empirically-

³ Plaintiffs' Supplemental Submission regarding Class Certification Loss Causation Issue on Remand From the Fifth Circuit Court of Appeals, dated November 1, 2007.

⁴ *Ibid*, p. 1. The use of the word "restatement" here is an unfortunate characterization of what happened as Allegiance did not actually restate its line count, it merely reconciled the line count from two different databases that had different numbers. Analysts typically referred to the change as "differences", as an "adjustment", and as a "reconciliation", as illustrated in Exhibit 5.

based showing that the corrective disclosure was more than just present at the scene' of the massive sell-off.”⁵

11. In support of Plaintiffs' Supplemental Submission, Ms. Preston filed a second report (“Preston’s Second Report”) wherein she referenced a second event study that produced yet a different “residual” price decline (allegedly amounting to \$1.14).⁶ Related to that price change, Ms. Preston’s two key assertions are that:

- a) “Artificial Inflation of Line Count is Material and Actionable”⁷
- b) “The Line Count Restatement Was the Primary Cause of Investor Losses”⁸

IV. SUMMARY OF MY OPINIONS

12. It is my opinion that there is no evidence that the reconciliation of the line count had anything to do with the stock price change on February 20, 2002, and Ms. Preston’s analysis is flawed in ways that make it unreliable. There are three main reasons for my opinion:

- a) Preston’s qualitative review of analysts’ reports was a mischaracterization of their commentary, which if taken at face value, will lead to erroneous conclusions.
- b) Preston’s quantitative analysis is superficial and contains errors that render it useless for determining the cause of Allegiance’s stock price change on February 20, 2002.
- c) Most of the drop observed in Allegiance’s stock price on February 20, 2002 was due to the increased risk and the corresponding increases in discount rates, triggered by Allegiance’s mixed to weak 4Q01 financial results and even

⁵ *Ibid*, p. 1.

⁶ Preston does not explain why she is now using a different regression model and she does not provide enough supporting information for me to replicate her current residual returns. However, my own analysis indicates that the price change on February 20 was statistically significant and, while we might differ on the amount of the residual return on that day, the real issue is whether the information about line count “caused a significant part of the \$1.05 price decline.” If it were a close call it could be important to be precise in the measurement of the residual return, but as will be seen later, it is not a close call.

⁷ Plaintiffs Supplemental Submission Regarding Class Certification Loss Causation Issues On Remand From the Fifth Circuit Court of Appeals, dated November 1, 2007, p. 19.

⁸ *Ibid*, p. 21.

more so by the lowered guidance and the possibility of covenant violations.

V. ANALYSIS OF THE EVIDENCE

13. After the close of the market on February 19, 2002, the Company announced its fourth quarter and year-end results. This was followed that night and throughout the following day by the release of over 20 analyst reports and other public discussion of the Company's press release. In response to the change in the total mix of information, the stock price declined \$1.05 between the close on February 19 and the close on February 20, a decline of 28%.
14. The two questions that arise from such an event are 1) was the price change statistically significant, and, if so, 2) what caused the price change?
15. To analyze the statistical significance of the price change requires an event study. Ms. Preston says that she undertook such a study, but she did not disclose the necessary underlying parameters and data for her model to enable me to replicate it. However, as stated earlier, since my own event study found the price change to be statistically significant, I will put this issue aside for the present undertaking.
16. Of paramount importance at this time is the question of what caused the price change? As stated above, it is Preston's opinion that the line count was material and that the line count (which she incorrectly labels "restatement") was the primary cause of investor losses. As support for her position she essentially summarizes her interpretation of what analysts were saying, and she presents an arithmetic exercise that purports to break down the components of the price change on February 20.

Preston's qualitative review of analysts' reports was a mischaracterization of their commentary, which if taken at face value, will lead to erroneous conclusions.

17. I find it difficult to interpret the analyst reports the same way as Ms. Preston.

So, I am presenting exactly what the analysts said about each of the relevant issues so that readers can draw their own conclusions.

18. First, I turn to her claim that Q4 results were essentially in line with analysts' expectations: "The majority of analysts following Allegiance at the time reported that Q4 results were essentially in line with expectations (see below)." (Paragraph 18, line c.)

19. My own interpretation of the analysts' comments would be "below expectations". Exhibit 3 provides a comprehensive commentary, good and bad, from the analysts on the subject of the Q4 results. As one can see, there were, indeed, some comments about the Company meeting certain expectations, but there were also a lot of comments that the results were below expectations, in contrast to the interpretation of Ms. Preston that results were "essentially in line with expectations"⁹:

- a) Salomon Smith Barney (2/19): "EBITDA losses slightly worse than our est."
- b) Baird (2/20): "Allegiance reported Q4 results that were just slightly below our expectations."
- c) BB&T (2/20): "[Q4'01 revenue and EBITDA] were lower than our estimates..."
- d) Bear Stearns (2/20): "fourth quarter losses that fell short of our top-line expectations."
- e) CIBC (2/20): "[EBITDA losses] were slightly below both our forecast of a loss...and company guidance of a loss..."
- f) Goldman Sachs (2/20): "slightly below our estimates."
- g) Hibernia Southwest Capital (2/20): "slightly below our estimates."

⁹ Clearly, given the stock price reaction, something happened that was not consistent with expectations.

- h) JP Morgan H&Q (2/20): “[EBITDA loss] slightly wider than our \$21 million loss estimate, and at the low end of management’s guidance.”
- i) Lehman Brothers (2/20): “slightly below our \$152.8 estimate.”
- j) McDonald Investments (2/20): “4Q’01 revenue results fall slightly short of expectations.”
- k) RBC Capital Markets (2/20): “Allegiance’s 4Q’01 results fell short of expectations.”
- l) Thomas Weisel Partners (2/20): “[Quarterly revenue] slightly below our \$154.0 million estimate.”

20. Ms. Preston said in paragraph 9 of her report, “Analysts following the Company during the proposed Class Period recognized the importance of line count in assessing the Company’s future revenue growth.” The question is how that translates into earnings and value. To that end, on page 6 she points to a Stephens report dated September 27, 2001, that discusses Enterprise Value per line. Ms. Preston also cites multiple times a Stephens report dated February 20, 2002 (referring to other issues)¹⁰, but she overlooks the following paragraphs from this same analyst report:

“In a *Research Bulletin* published October 24, 2001, after it released third-quarter earnings and operating data, we wrote: ‘We will no longer value Allegiance’s shares on an access line equivalent basis because we think those numbers are losing their relevance.’ As if to confirm our doubts, the carrier announced yesterday that it would reduce by about 12% its claimed ‘line equivalents’ served, explaining that inconsistent billing records had inflated its prior count by 125,000 voice ‘equivalents.’...

¹⁰ Ms. Preston cites this report in paragraphs 24 and 31, and in Exhibit C.

In any case, we value Allegiance using a Discounted Cash Flow model. We have raised the discount rate in our model from 18% to 20%, in response to the slight softening of Allegiance's outlook and the marked softening of telecom investor sentiment toward CLEC sector. This, in addition to other changes in our model, brings our one-year target price to \$13 [down from \$16, or 18.8%]" (Brackets mine.)

21. The Stephens report makes a strong case that the valuation metric EV/line count used by Ms. Preston is not a relevant metric. Most importantly, the preferred valuation methodology used by financial analysts, and the appropriate one, is a discounted cash flow model. Moreover, Ms. Preston seems to agree with this in her report when she correctly says that "the stock price reflects the present value of future cash streams," citing a well-known finance text book. Nevertheless, in her analysis she does not use, or even mention again, a valuation method based on discounted future cash flows. An appropriate valuation methodology based on *future* cash flows is not affected by the line count reconciliation during the fourth quarter ending in December 2001.

22. Ms. Preston also said in paragraph 11 that, "The restatement was ill-received by the market" and provided some analysts' quotes that were ambiguous. What is clear is that of the 22 analyst reports published on February 19 and February 20 that she provided as back-up, not one analyst attributed the change in stock price on February 20 to the line count reconciliation. For example, Exhibit 4 shows the headlines of each analyst report; not one of

them mentions line count, but they did mention the mixed results and lowering of forward-looking estimates. Furthermore, I read through each of these analyst reports in detail, and Exhibit 5 shows every comment that I found on this subject. First, one can see that most analysts referred to the change in numbers as “reconciliations” or “adjustments” and explained how this resulted from a simple reconciliation of internal databases. Second, the tone of the reports was more of a “so what” (especially as the change in line count did not materially affect revenue) and, I suggest, “immaterial”¹¹ would be a better description of how they viewed the reconciliation.

23. Allegiance confirmed that “[t]his adjustment had no impact on our revenues because the lines taken out of our reported installed line base were not in our billing systems and were therefore not generating revenue.”¹² Furthermore, the Company had previously explained the issues relating to its information systems, including potential accuracy issues related to its line count. In other words, the market was aware that the line count numbers could be subject to potential adjustments. For example, the Company said the following, in its quarterly report filed on November 14, 2001:

“Since our inception, we have also been engaged in developing and integrating our essential information systems consisting of our billing system, our sales order entry system, our customer implementation system and our switch information systems. This is a challenging project because

¹¹ USB Warburg report; 2/20/02; p. 3.

¹² Allegiance Telecom Form 10-K for the year ended December 31, 2001, pp. 34-35.

these systems were developed by different vendors and must be coordinated through custom software and integration processes. Our sales, line count and other core operating and financial data are generated by these systems and the accuracy of this data depends on the quality and progress of the system integration project. Although we have made significant progress in our system integration efforts, we have not completed it and we have experienced and expect to experience negative adjustments to our financial and operating data as we complete this effort. These adjustments have not had a material adverse effect on our financial or operating data to date but until we complete the entire project we cannot assure you that any such adjustments arising out of our systems integration efforts will not have a material adverse effect in the future.”¹³

24. In fact, the Robertson Stephens report dated February 20, 2002, also cited twice by Ms. Preston,¹⁴ stated clearly that the line count reconciliation was immaterial:

“The line reconciliation did not have a material impact on revenues and does not have a material impact on projections.”

25. It is clear to me that the line count adjustment was not relevant to analysts in their valuation of Allegiance. Exhibit 6 contains quotes from the analyst reports supplemented to Ms. Preston’s report; these quotes pertain to the projected performance of Allegiance. Again, it is clear that the majority of the analysts she includes in her Exhibit C were lowering revenue and/or

¹³ Allegiance Telecom Form 10-Q for the period ended September 30, 2001, pg. 25-26

¹⁴ Ms. Preston cites this report on paragraph 31 and in Exhibit C.

EBITDA targets; and not one analyst attributed lower expected performance to line count reconciliation. Also, not one analyst increased his or her rating; several “maintained” the rating; while several lowered their ratings. This is consistent with the headlines that results were “mixed”. Also, not one analyst attributed the ratings or target changes to line count. In Exhibit 7 I show the valuation methodologies employed by each equity analyst, if they mentioned their methodology in their reports. Eleven of the seventeen equity analysts reported their valuation methodologies.¹⁵ A few analysts reported more than one valuation methodology, for a total count of fourteen. Overall, seven of the eleven analysts reported using a DCF (discounted cash flow) valuation model, three reported using a multiple of EBITDA, and only two reported using a multiple of revenues.¹⁶ Not one of these analysts following the February 19 announcement reported using line count to value Allegiance, which is consistent with the Stephens report stating that that method was inappropriate.

26. Interestingly, Ms. Preston’s footnote 14 quotes US Bancorp Piper Jaffray on 2/20/02 as, “Note, we currently consider revenue, EBITDA, and capex the relevant metrics to track”. In reading this report I found that this analyst did not even mention line count, but did use DCF in his valuation. Ms. Preston can’t have it both ways!

¹⁵ I only count equity analysts here, since those analysts focusing on Allegiance bonds (debt) do not focus on the market value of Allegiance, but rather on the variables affecting the value of its debt, such as the probability of default.

¹⁶ The other two valuation methodologies used by equity analysts were EV/Last quarter annualized revenues and EV/ Property, Plant & Equipment, each used once.

27. As a supplement to Exhibit 7, in Exhibit 8 I present comments analysts made about the valuation of Allegiance. Clearly, the combination of their changes in future projections and discount rates produced valuation percentage declines that were consistent with Allegiance's stock price decline on February 20.

Preston's quantitative analysis is superficial and contained errors that render it useless for determining the cause of Allegiance's stock price change on February 20, 2002.

28. In her report (p. 2) Ms. Preston states that, "I have applied standard econometric measures to quantify that portion of the February 20, 2002 decline in Allegiance's stock price that is attributable to the disclosure of the restatement of line count." She did not conduct an econometric study to estimate the alleged impact of the line count revision on Allegiance's firm value and she really overstates the arithmetic calculation that she did.¹⁷ Her calculations, outlined in pages 4-10 of her report, simply take what she calls the enterprise value (the sum of market value of equity and debt, less cash), using the value of debt and cash as reported on November 14, 2001, divided by the line count. As support for this calculation, she cited outdated analysts' reports that calculated an EV/line count multiple. The most recent of these reports is by Stephens, dated September 27, 2001, the same analyst I quote above stating only a month later that they will no longer use this valuation metric. She then multiplies this number by the reconciled line count and gets

¹⁷ William S. Brown, in Introducing Econometrics, (West Publishing Co., 1991); p. 1, says, "Econometrics is a set of *statistical techniques* used in the analysis of empirical data" (italics my own). Preston does not use any statistical techniques in her calculations.

a figure of \$0.83, and she says this is a significant part of the price decline of \$1.14.¹⁸

29. There are at least four serious problems with her calculation, as follows:

- a) The method is not appropriate for valuation, as stated earlier by the Stephens report. That she arrives at a calculation of \$0.83 a share is misleading and irrelevant to the issue at hand.
- b) As shown earlier, none of the analysts around February 20 used this methodology.
- c) The analyst reports she cites using EV/line count are outdated.
- d) Even if the approach were valid, which it is not, her analysis is at best incomplete. She defines enterprise value as the sum of the market value of equity and debt, less cash; but she attributes the total enterprise value decline to a decline in equity, leaving out debt and cash. She uses (paragraph 14) the market value of equity as of February 19, 2002, and the debt and cash of the company as of September 30, 2001 reported in the November 14, 2001 10-Q. She makes no attempt to look at the possible changes in the value of debt and cash between that time and February 20, 2002. It is entirely possible that debt and/or cash also declined in value over that time period. Goldman Sachs, for example, on 2/20 downgraded the bonds stating, "the company has modest room to revise its numbers downward in the future" and "the company is arguably under funded for its full business plan." Since a violation of its covenants and bankruptcy were a threat, I would expect a downgrade and increased risk to adversely affect the value of Allegiance's debt.

30. As is usually the case with stock price changes, this story is about the change in the expected future earnings of the company. Ms. Preston admits as much in paragraph 25: "In general, the market and stock prices are said to be 'forward looking' in that the stock price reflects the present value of the future cash streams associated with owning the security." That, quite simply, is what financial theory says drives stock prices, and it is changes in future

¹⁸ Preston's Second Report, p. 9.

expected cash flows that cause stock price changes. That is the case here, as well.

31. Next, in paragraphs 26-28 she looks at the “\$5 million reduction in estimated revenue,” that she says is based on the average decline cited by analysts and presented in her Exhibit C, and multiplies the average revision in analysts revenue estimates for 2002 by her EV/2002 Revenue multiple of 1.1. She concludes that the impact to Allegiance equity value from revenue and EBITDA revisions was \$0.05 per share. There are a number of problems and inaccuracies in her analysis. First, as I mentioned before, she completely ignores the valuation methodology (DCF) preferred by financial analysts and finance text books. Second, she claims that “the EV/EBITDA multiple was not meaningful because Allegiance...was in a growth phase, not generating positive EBITDA, and not expected to generate positive EBITDA for some time.” However, after the DCF methodology, EV/EBITDA was the most common valuation methodology among analysts following Allegiance. As I show in Exhibit 7, three out of the eleven equity analysts used this multiple, based on their estimates of 2003 EBITDA, to value Allegiance. The reason for this is that Allegiance was expected to generate positive EBITDA starting a few months later, in the second half of 2002. It is surprising to me that Ms. Preston considers this too far into the future, especially given that a) stock prices are “forward looking” and b) it is a common practice to use projections

of five to ten years when valuing a firm, as the DCF models presented by the financial analysts following Allegiance show.¹⁹

32. What is important in this case are the revisions to future cash flows and changes to the variables used to calculate the “present value of future cash streams.” There is no doubt that analysts were revising downward both future revenues and EBITDA, leading to lower valuations. Ms. Preston’s Exhibit C shows that some analysts were reducing revenue estimates by as much as \$32 million (Robertson Stephens) and EBITDA by as much as \$21.68 million dollars (Stephens).²⁰ Although, as described earlier, the reviews and changes in projections were “mixed,” some analysts were making significant downward revisions in revenues and EBITDA. Ms. Preston claims that the “reduction in revenue estimates was larger than the reduction in the EBITDA estimates.” This statement is misleading if we take into account that her estimated revision of \$5.2 million represents a reduction of 0.66% of the average revenue estimate (\$792.6 million), compared to the average revision of -24.4% of EBITDA estimates.²¹

Most of the drop observed in Allegiance’s stock price on February 20, 2002 was due to the increased risk and the corresponding increases in discount rates, triggered by Allegiance’s mixed to weak 4Q01 financial results and even more so by the lowered guidance and the possibility of covenant violations.

33. In my opinion, one of the most important facts overlooked by Ms. Preston is that financial analysts were increasing the discount rate used in the DCF

¹⁹ See for example the BB&T Capital Markets report on February 20, 2002 and the Robertson Stephens report on February 20, 2002.

²⁰ Ms. Preston’s estimate of revenue revisions excludes a report by RBC Capital (which was part of her report) that reduced its 2002 revenue estimate by \$12 million. If included, it would change her calculation.

²¹ A \$4 million revision on a base of a loss of \$16.3 million.

models, reflecting the increased risk of investing in Allegiance, which is unrelated to the reconciliation of line counts. For example, following Allegiance announcement on February 19, Salomon Smith Barney increased the discount rate to 18% to reflect a 31% increase in systematic risk (as measured by the increase in Allegiance's beta from 1.3 to 1.7) and reduced its target price by 40%:

"We are also lowering our price target from \$10 to \$6, which is based on our new 10-year DCF model using about an 18% discount rate and an 8x terminal multiple. The new DCF uses a higher discount rate that reflects a higher beta of almost 1.7 versus the previous beta of 1.3 (Bloomberg adjusted betas)." (Salomon Smith Barney, February 19, 2002)

34. Similarly, Stephens increased its discount rate from 18% to 20% "in response to the slight softening of Allegiance's outlook and the marked softening of telecom investor sentiment toward the CLEC sector" and reduced its target price by 19%, from \$16 to \$13:

"We have reduced our one-year target price to \$13 per share from our prior target of \$16. ... In any case, we value Allegiance using a Discounted Cash Flow model. We have raised the discount rate in our model from 18% to 20%, in response to the slight softening of Allegiance's outlook and the marked softening of telecom investor sentiment toward the CLEC sector." (Stephens Inc., February 20, 2002)

35. Increases in discount rates have a substantial impact on firm valuation in a DCF framework. On February 20, 2002, BB&T published a report that provides a good illustration of the specific impact of increased discount rates on Allegiance's value. This report shows that increasing the discount rate from 17% to 20% translates into a 28% reduction in the estimated target price from \$16.30 to \$11.80. This report also shows that a further increase in the discount rate from 20% to 23% would reduce the target price to \$8.30, or a decline of 30%. In Exhibit 9 I show the combinations of discount rates and terminal multiples that they presented in their report. Increases in the discount rates of 3 percentage points produced valuation declines of around 28% to 30%, which matches the 28% stock price decline of Allegiance on February 20.
36. It is my opinion that this increased risk is due to Allegiance's mixed to weak 4Q01 results and even more so to the lowered guidance and the risk of covenant violations. The resulting increase in discount rates explain most of the drop observed in Allegiance's stock price on February 20, 2002.
37. Finally, it is instructive to look at what happened to Allegiance's stock price on February 19 and February 20, 2002. Exhibit 10 presents the intraday charts of Allegiance's stock price, showing trade-by-trade data throughout these two days. As is clear, even though the stock price was down from closing price to closing price on February 19 and February 20, the intraday analysis shows that the price actually opened up in trading on the 20th.

38. In an efficient market stock prices respond quickly to new information. Since the company had released the line count information on February 19 after the close of trading, if this were the significant information that Ms. Preston maintains it to be, one would expect to see a quick response (decline) in the stock price shortly after the release of this news including on the opening of the trading of the stock on February 20. Since the stock price was actually up following the release of the news and at the opening of trading, this stock price reaction is inconsistent with the opinion of Ms. Preston.
39. As outlined earlier, analysts' evaluations of Q4 were mixed, but most of them were revising downward their forward looking forecasts of revenue and EBITDA, and some of those who were using DCF for valuation were increasing the discount rate to reflect the increased riskiness. This picture of the stock price decline during the day on February 20 is consistent with the market re-evaluating the "mixed" information about the future earning power and riskiness of Allegiance and revaluing the stock on that basis throughout the day.

VI. SUMMARY OF THE EVIDENCE

40. In summary:

- a) There is no evidence that the reconciliation of line count had any impact on Allegiance's stock price.
- b) Revenues were not affected and the reconciliation had no affect on the future earning power of Allegiance.
- c) Line count information was not relevant information in the valuation of Allegiance:
 - i. None of the analysts considered line count in valuing Allegiance
 - a. In fact, the Stephens reports, cited earlier, said that was an improper way to look at valuation
 - ii. Most analysts lowered their projections

- iii. All of the analysts that provided a valuation methodology used either DCF or a multiple of EBITDA or revenues in their valuations
 - iv. The changes in projections and discount rates (reflecting the riskiness of the future earnings and the risk of not meeting their covenants) accounted for most, if not all, of the decline in market value of Allegiance.
- d) The change in stock price on February 20 is inconsistent with Preston's opinion that the line count reconciliation released the previous day was instrumental in the price decline; it is consistent with the re-evaluation of information by the marketplace over that day regarding the future earning power and riskiness of Allegiance and revaluing the stock downward.

/s/ James K. Malernee, Jr.
James K. Malernee, Jr.
December 3, 2007

EXHIBIT 1
JAMES K. MALERNEE, JR.
Managing Director & Chairman

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ACADEMIC BACKGROUND

| | | |
|-------------|--|---------------|
| 1970 & 1977 | The University of Texas at Austin <i>Ph.D. with emphasis on financial management and investment theory, 1977</i> <i>Secondary field in real estate, and an outside field in applied statistics</i> <i>BS, petroleum engineering, 1970.</i> | Austin, Texas |
| 1972 | Southern Methodist University <i>MBA</i> | Dallas, Texas |

PROFESSIONAL BACKGROUND

Cornerstone Research, Inc.

President and CEO

Responsibilities, in addition to running the firm, include defining scope of research and analysis, managing completion of tasks by project teams, interfacing with attorneys and testifying experts, and presenting the findings of the research. Experience includes the following:

- Over 500 securities cases. Issues have included material disclosure (Rule 10b-5 and Section 11 allegations), inside trading, merger/acquisition activities (such as greenmail, poison pills, golden parachutes, etc.), minority buyouts, stock trading behavior, earnings restatements and valuation.
- Large case management of antitrust and intellectual property cases dealing with multiple experts.
- General business issues such as viability of the firm, appropriateness of merger/acquisition decisions, reasonableness of a divestiture, and management/board of directors decision-making.

The MAC Group

Senior Vice President

Directed consulting studies in the areas of strategic planning, financial planning and control, organization structure, mergers and acquisitions, and market research. Director of MAC Research, the business unit established for consulting and expert testimony in litigation.

Graduate School of Business, Stanford University

Lecturer in management

Taught second-year MBA course on Industry Analysis and Competitive Strategy.

EXHIBIT 1
JAMES K. MALERNEE, JR.
Managing Director

PROFESSIONAL BACKGROUND (CONT.)

University of Texas at Austin

Lecturer/teaching assistant in finance

Taught various courses in corporate finance and investments.

Harris Upham & Co.

Registered representative in securities and commodities.

PUBLICATIONS

"Managing and Growing the Consulting Firm", co-authored with Larry E. Greiner in The Contemporary Consultant (Southwestern, Thomson; 2004), edited by Larry Greiner and Flemming Poulfelt.

"Securities Reform: Implications for Damages," 1997. Co-authored by William H. Beaver and Cynthia L. Zollinger.

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"Stock Trading Behavior and Damage Estimation in Securities Cases," working paper, 1991. Co-authored with William H. Beaver and Michael C. Keeley.

"Estimating Damages in Securities Cases," working paper, 1989. Co-authored with William H. Beaver.

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"Reducing Risk in Financial Lease Commitments," *Risk Management*, September 1976. Co-authored with A.J. Senchack.

"Utility Theory: The Foundation of Financial Theory," working paper, The University of Texas Bureau of Business Research, January 1976.

EXHIBIT 1
JAMES K. MALERNEE, JR.
Managing Director

PUBLICATIONS (CONT.)

“Assured Residual Values in Bank Leasing Arrangements,” working paper and published in the *Journal of Commercial-Bank Lending*, September 1975. Reprinted by the Southwestern Graduate School of Banking, Dallas, Texas. Co-authored with A.J. Senchack.

Paper discussant and session chairman at various association meetings.

Exhibit 2

DOCUMENTS RELIED UPON

| Document Title / Source | Bates Numbers | Document Date |
|--|---------------|--------------------|
| <u>Legal Documents</u> | | |
| Report of Candace L. Preston, CFA in Support of Plaintiff's Motion for Class Certification | | September 21, 2004 |
| Rebuttal Report of Candace L. Preston, CFA in Response to Holland and Parella's Opposition to Plaintiff's Motion for Class Certification | | January 7, 2005 |
| Second Report of Candace L. Preston, CFA in Support of Plaintiff's Motion for Class Certification | | October 31, 2007 |
| Plaintiffs' Supplemental Submission regarding Class Certification Loss Causation Issue on Remand From the Fifth Circuit Court of Appeals | | November 1, 2007 |
| <u>Academic Literature</u> | | |
| Brealey, Richard A., and Stewart C. Myers, <i>Principles of Corporate Finance</i> , McGraw-Hill/Irwin, 7th Ed., 2003 | | |
| Brown, William S., <i>Introducing Econometrics</i> , West Publishing Co., 1991 | | |
| <u>SEC Filings</u> | | |
| Allegiance Telecom, Inc. 10-Q for the quarter ending March 31, 2001 filed on April 1, 2002 | | |
| Allegiance Telecom, Inc. 10-Q for the quarter ending June 30, 2001 filed on August 14, 2001 | | |
| Allegiance Telecom, Inc. 10-Q for the quarter ending September 31, 2001 filed on November 14, 2001 | | |
| Allegiance Telecom, Inc. 10-K for the year ending December 31, 2001 filed on May 2, 2001 | | |
| <u>Analyst Reports</u> | | |
| Stephens, Inc. | | October 24, 2001 |

Exhibit 2

| Document Title / Source | Bates Numbers | Document Date |
|--|------------------------------|-------------------|
| Bear Stearns | TK0000132 – TK0000134 | February 19, 2002 |
| Credit Suisse First Boston | CSFB0000033 – CSFB0000040 | February 19, 2002 |
| Salomon Smith Barney | | February 19, 2002 |
| Baird | TK0000135 – TK0000139 | February 20, 2002 |
| BB&T Capital Markets | TK0000108 – TK0000114 | February 20, 2002 |
| Bear Stearns Fixed Income | | February 20, 2002 |
| CIBC World Markets | | February 20, 2002 |
| Deutsche Banc Alex. Brown | TK0000121 – TK0000127 | February 20, 2002 |
| Fitch | FI-ALLEGIANCE 000588 | February 20, 2002 |
| Goldman Sachs Global High Yield Research | TK0000115 – TK0000120 | February 20, 2002 |
| Hibernia Southcoast Capital | TK0000146 – TK0000147 | February 20, 2002 |
| JP Morgan H&Q | | February 20, 2002 |
| Lehman Brothers | LB001 – LB006 | February 20, 2002 |
| McDonald Investments | | February 20, 2002 |
| RBC Capital Markets | TK0000098 – TK000100 | February 20, 2002 |
| Robertson Stephens | TK0000101 – TK000107 | February 20, 2002 |
| Salomon Smith Barney | TK0000144 – TK000145 | February 20, 2002 |
| Stephens, Inc. | TK0000085 – TK000087 | February 20, 2002 |
| Thomas Weisel Partners | TK0000088 – TK000092 | February 20, 2002 |
| UBS Warburg | | February 20, 2002 |
| UBS Warburg | UBS 89 – UBS 92 | February 20, 2002 |

| Document Title / Source | Bates Numbers | Document Date |
|--------------------------|----------------------|-------------------|
| US Bancorp Piper Jaffray | TK0000093 – TK000094 | February 20, 2002 |

Conference Call Transcripts

| | |
|---|-------------------|
| Allegiance Telecom, Inc. Q4 2001 Earnings Conference Call | February 19, 2002 |
|---|-------------------|

Press Releases

| | |
|--|-------------------|
| “Allegiance Telecom Announces Solid Fourth Quarter and Year-End,” Allegiance Telecom Press Release | February 19, 2002 |
|--|-------------------|

Data Sources

Allegiance Telecom, Inc. intraday stock data, *TAQ*, 2/19/02 – 2/20/02

Allegiance Telecom, Inc. stock data, *CRSP*, 4/3/00 – 5/23/03

Various index price data, *Bloomberg*, 4/3/00 – 5/23/03

All Other Materials Cited in This Declaration and the Exhibits to This Declaration

Exhibit 3

Analyst Reports: Commentary on Q4/FY01 Results

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Q4/FY01 Results |
|------------------------|----------------------------|--|
| 2/19/02 | Bear Stearns | "Allegiance Telecom reported 4Q01 revenue that was inline with expectations while the remainder of the reported results were within guidance. Revenues for the quarter were \$151.8 million slightly exceeding our expectations of \$150.5 million, but falling in the lower range of street consensus of \$150-\$155 million...." |
| 2/19/02 | Credit Suisse First Boston | "On Feb 19, ALGX rpt'd 4Q01 results with total revs in line with our est. and with EBITDA, net of a non-rec \$5.5M chg, slightly ahead of our f'cst. However, local revs were weak, coming in 3% below our f'cst and w/only 2% sq'tl growth. Lowering '02 revenue f'cst and widening '02 EBITDA loss est, as we cont. to remain concerned regarding the impact that a slowing economy will have on both the pace of new rev bookings as well as cust. churn over the next 2-3 qtrs." |
| 2/19/02 | Salomon Smith Barney | "ALGX reported mixed 4Q results w/revs slightly higher than our est.. which was at low end of guid. range, & EBITDA losses slightly worse than our est." |
| 2/20/02 | Baird | "Allegiance reported Q4 results that were just slightly below our expectations. Total revenue increased 59.8% YOY and 12.3% sequentially to \$151.8 million, which was basically in line with our \$152.0 million forecast with disappointing local results offset by better-than-expected data and long-distance revenue. Local revenue of \$87.5 million was up 33.1% YOY and 2.5% sequentially, but \$9.6 million lower than expected. Data services revenue of \$54.4 million was up 116.8% YOY and 29.8% sequentially and was \$8.0 million ahead of our projection. Long-distance revenue of \$9.9 million was up 137.2% YOY and 26.6% sequentially and was \$1.3 million better than expected. Gross profit increased 62.6% YOY and 12.1% sequentially to \$77.8 million, which was in line with our estimate. EBITDA losses of \$27.7 million were \$6.7 million higher than expected, but included a \$5.5 million non-recurring charge." "While the results were respectable, in our view, Q4'01 revenue of \$151.8 million and EBITDA of a loss of \$22.2 million were lower than our estimates of \$157.3 million and a loss of \$21.8 million, respectively...." |
| 2/20/02 | BB&T Capital Markets | "Allegiance Telecom, a smart-build competitive local-exchange carrier (CLEC), has reported fourth-quarter results that fell short of our top-line expectations. The company reported 4Q01 revenues of \$151.8 million, an increase of 12.4% from \$135.1 million in 3Q01 but slightly below our \$155.0-million estimate. Allegiance met our EBITDA forecast, reporting a decline in losses to \$(22.2) million excluding a \$5.5-million non-recurring charge related to acquisitions." |
| 2/20/02 | CIBC World Markets | "Revenue during the quarter totaled \$151.8 million, up 12% sequentially and in line with our recently reduced forecast. This was made up of \$87.5 million in local revenue (up from \$85.4 million in 3Q), \$54.4 million in data revenue (up from \$41.9 million in 3Q), and \$9.9 million in long distance revenue (up from \$7.9 million in 3Q), with local revenue slightly weaker and date revenue slightly stronger than expected.... However EBITDA losses of \$22.2 million (excluding the aforementioned one-time charge) were slightly below both our forecast of a loss of \$21.6 million and company guidance of a loss in the \$21-\$22 million range...." |
| 2/20/02 | Deutsche Bank Alex. Brown | "ALGX reported 4Q01 rev of \$152Mn, slightly better than our \$150Mn est. The company generated an EBITDA loss of \$28Mn, in-line with our est of a loss of \$21Mn when adjusting for a \$5.5Mn non-recurring charge to SG&A - equating to a loss of \$22Mn." |
| 2/20/02 ^[1] | Fitch Ratings | — |

Exhibit 3

Analyst Reports: Commentary on Q4/FY01 Results

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Q4/FY01 Results |
|------------------------|--|---|
| 2/20/02 ^[2] | Goldman Sachs Global High Yield Research | "Allegiance Telecom posted fourth quarter results, slightly below our estimates. The company increased revenue 12% sequentially to \$152 million, which was below our estimate of \$154 million. Revenue growth was driven by the data and Internet segment.... ...With the increase in SG&A, Allegiance's EBITDA of \$(22) million was slightly greater than our estimate of \$(20) million." |
| 2/20/02 | Hibernia Southcoast Capital | "ALGX's 4Q01 results for revenue and EBITDA (see table) were just slightly below our estimates, however inline with previous guidance. Fourth quarter revenues grew 12.3% and adjusted 4Q01 EBITDA margin improved 500 basis points sequentially. Full year revenues grew 81.2% and full year adjusted EBITDA margin improved 2,070 basis points year over year." |
| 2/20/02 | JP Morgan H&Q | "Total revenue of \$152 million was just shy of our \$153 million estimate, as the company overcame top-line headwinds in the form of pending order disconnects by customers whose orders became stale due to provisioning difficulties in the wake of September 11. The churn effect was magnified by an accounting house cleaning undertaken in December and completed in February which resulted in a restated line count...and a one-time charge of \$5.5 million impacting EBITDA. EBITDA loss for the quarter was \$27.7 million including the \$5.5 million charge related to the writeoff of some acquisition-related assets, with a core EBITDA loss for the quarter of \$22 million, slightly wider than our \$21 million loss estimate, and at the low end of management's guidance...." |
| 2/20/02 | Lehman Brothers | "Overall top line of \$151.8M came in-line with revised guidance and just slightly below our \$152.8M estimate. In aggregate, absolute revenue growth improved 4-fold to nearly \$20M off 3Q01's trough, adjusting for contra-revenues, acquisition, and line reconciliation impacts...." |
| 2/20/02 | McDonald Investments | "ALGX's 4Q01 revenue results fall slightly short of expectations.... On the top line, the Company posted 4Q01 revenues of \$151.8 million, up 12.3% sequentially and 59.8% year-over-year, marginally below our \$154.6 million target.... ...EBITDA shortfall and interest expense impact bottom line. In terms of gross margin, the Company's 51.3% 4Q01 value came in [sic] in line with our estimates for the quarter, declining over last quarter's 51.4% level but improving our last year's 50.4% mark...." |
| 2/20/02 ^[3] | RBC Capital Markets | "Allegiance's 4Q01 results fell short of expectations. Revenues totaled \$151.8 million vs. our \$155.3 million estimate, on approximately 135,000 new lines installed (10,000 fewer than our estimate). Gross margins of 51.3% (vs. our 52.8% estimate) were essentially flat with 51.4% during 3Q01. Despite the \$3.5 million revenue shortfall, lower-than-expected SG&A costs resulted in an EBITDA loss (\$22.2 million, excluding \$5.5 million of nonrecurring charges) that was \$1 million larger than our estimate...." |
| 2/20/02 | Robertson Stephens | "Allegiance revenues increased 12% sequentially in Q4 to \$151.8 million, just 2% shy of revised guidance.... ...The company reported an adjusted EBITDA loss of \$22.2 million in Q4, after a one-time non-recurring charge of \$5.5 million, representing a sequential improvement of \$4.2 million...." |

Exhibit 3

Analyst Reports: Commentary on Q4/FY01 Results

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Q4/FY01 Results |
|-----------------|---|--|
| 2/20/02 [2],[3] | Salomon Smith Barney Corporate Bond Research | "ALGX reported results that were at expectations...." |
| 2/20/02 | Stephens Inc. | "Fourth-quarter revenues of \$152 million compared with our forecast of \$156 million, while EBITDA of (\$27.7 million) compared with our forecast of \$20 million. According to Company management, about \$5 million of the fourth-quarter EBITDA loss was generated by Allegiance's decision to take increased reserves related to past acquisitions. On a conference call, management described the move as a one-time adjustment." |
| 2/20/02 | Thomas Weisel Partners | "Allegiance reported December quarterly revenue of \$151.8 million, slightly below our \$154.0 million estimate. EBITDA was (\$22.2) million (excluding \$5.5 million in one-time expenses), within the range of the company's previous guidance, and roughly in line with our (\$20.0) million estimate...." |
| 2/20/02 | UBS Warburg | "...The company reported 4Q01 revenue of \$151.8 million, which reflects 12% sequential growth, but was still 1% below our expectations. ... ALGX's EBITDA loss declined to \$27.7 million, which includes a one-time charge of \$5.5 million. Excluding this charge, its \$22.2 million loss is a 16% improvement compared to its loss of \$26 million in 3Q01. This loss exceeded our estimate by 5%, and was slightly below management's guidance of \$20 to \$22 million loss...." |
| 2/20/02 [3],[4] | UBS Warburg | "Allegiance Telecom hosted its 4Q01 conference call with investors yesterday after posting results that were below our estimates...." |
| 2/20/02 | US Bancorp Piper Jaffray | "4Q01 quarterly report in line with expectations. Revenue was \$151.8 million versus our estimate of \$151.0 million. Normalized EBITDA was (\$22.2) million versus our estimate of (\$21.0) million. Normalized EBITDA excludes a \$5.5 million one-time charge for merger expenses." |

Note:

[1] Analyst report covering Allegiance Telecom, Inc. credit rating.

[2] Analyst report covering Allegiance Telecom, Inc. bonds.

[3] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.

[4] Analyst report is a telecom sector overview not specific to Allegiance Telecom, Inc.

Exhibit 4

Analyst Reports: Headlines

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Headline |
|----------------------------|--|---|
| 2/19/02 | Bear Stearns | Allegiance Posts 4Q01 Results |
| 2/19/02 | Credit Suisse First Boston | 4Q Rpt'd: Qtr in line but Local Trends Weak. Cutting ests; Maintn Hold |
| 2/19/02 | Salomon Smith Barney | ALGX: Reports Mixed 4Q Results - Lowering Price Target to \$6 |
| 2/20/02 | Baird | Q4 Results Largely In Line; Lowering FY02 Revenue Estimate and Target |
| 2/20/02 | BB&T Capital Markets | ALGX: Respectable Q4'01, but Results Lower Than Our Estimates |
| 2/20/02 | Bear Stearns | Allegiance Telecom Posts Mixed 4Q01 Results |
| 2/20/02 | CIBC World Markets | After Mixed 2001, Looking for Better Execution in 2002 |
| 2/20/02 | Deutsche Banc Alex. Brown | In-line 4Q01 Results, '02 Guidance Reaffirmed |
| 2/20/02 ^[1] | Fitch Ratings | Fitch Ratings Affirms Allegiance Telecom's Debt |
| 2/20/02 ^[2] | Goldman Sachs Global High Yield Research | Allegiance Telecom: Fourth Quarter Update: Bank Debt Covenants Are Tight; Downgrading Bonds to Underperform |
| 2/20/02 | Hibernia Southcoast Capital | 4Q01/2001 Results - Trends Intact - Revising Estimates |
| 2/20/02 | JP Morgan H&Q | Positive 4Q Results; Maintaining 2002 Outlook |
| 2/20/02 | Lehman Brothers | 4Q01 In-Line; Visibility Cloudy |
| 2/20/02 | McDonald Investments | ALGX: Top CLEC Continues to Execute but Maintaining HOLD Rating |
| 2/20/02 ^[3] | RBC Capital Markets | 4Q01 Results Mixed; Maintain Sector Perform |
| 2/20/02 | Robertson Stephens | Q4 Results Weak, but Better than Peers |
| 2/20/02 ^{[2],[4]} | Salomon Smith Barney | Fourth Quarter Results Meet Expectations |
| 2/20/02 | Stephens Inc. | Reports Fourth Quarter; Reducing Our Rating to OUTPERFORM |
| 2/20/02 | Thomas Weisel Partners | Q4 Results In Line - Reiterated 2002 Guidance |
| 2/20/02 | UBS Warburg | Allegiance Telecom: In a Little While |
| 2/20/02 ^{[3],[4]} | UBS Warburg | Telco Wake-Up Call |
| 2/20/02 | US Bancorp Piper Jaffray | 4Q01 Revenue In Line with Expectations |

Note:

^[1] Analyst report covering Allegiance Telecom, Inc. credit rating.

^[2] Analyst report covering Allegiance Telecom, Inc. bonds.

^[3] Analyst report is a telecom sector overview not specific to Allegiance Telecom, Inc.

^[4] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|---------|----------------------------|---|
| 2/19/02 | Bear Stearns | <p>*Allegiance provisioned about 135,000 lines in 4Q01, essentially flat compared to the 136,200 line provisioned in 3Q01. 93% of Allegiance's 1.15 million access lines in service are now on-switch, and 50% of the new installs in 4Q01 were integrated access device (IAD) lines.</p> <p>...Allegiance's 36-market build-out was completed in 4Q01, and each market is now fully operational. Currently, the company has a total of 789 collocations in place, an increase of 17 collos for the period, along with 31 voice switches. This network infrastructure presently supports over 1.15 million access lines, and the total addressable market for the company now stands at 20.4 million access lines....</p> <p>...Management provided guidance for 2002 revenue of \$800 million and EBITDA loss of \$15-\$25 million for the year while provisioning 600,000 lines (previous guidance was for 650,000 lines in 2002). ... Capital expenditures for the year will be in the range of \$215-\$240 million (previously \$225-\$250 million) and mostly success based. About \$150-\$180 million has been allocated toward new line installations, while the remainder will be devoted towards maintenance and back office systems."</p> |
| 2/19/02 | Credit Suisse First Boston | <p>*Access Lines: ALGX added 135,000 net new lines during the quarter, down 1% sequentially and 7% below our estimate. Total lines in service at the end of the period were 1,015,000. During the quarter the company performed a reconciliation between its order management system and its billing system which resulted in a downward adjustment to lines service of 125,000, consisting of 95,000 UNE and 30,000 resale lines. As a result of the reconciliation, sequential comparisons are not meaningful as prior periods were not adjusted. Average revenue per line (ARPU) for the quarter was \$50.08, however the sequential comparison is not meaningful given the access line reconciliation in the quarter. We note that ARPU declined 7% and 2% in 3Q01 and 2Q01, respectively, owing to a decline in switched access rates."</p> |
| 2/19/02 | Salomon Smith Barney | <p>"There were 135,000 net lines installed in 4Q01, versus our estimate of 150,000, which brings total lines installed to 1,015,000. The company made a significant adjustment to its line count methodology, during 4Q01. The change was made as a result of the company's database reconciliation project. ALGX identified inconsistencies as a result of the manual data entry processes which were in operation before ALGX began its automated billing interfaces in 2Q01. The company made a negative adjustment of about 125,000 lines. In fact, ARPU increased to \$50.08 this quarter up from \$48.03 last quarter due to this adjustment. Lines sold was 190,000 in the quarter compared to 182,000 in 3Q01. For 2002, the company estimates a total of 600,000 net line adds...."</p> |
| 2/20/02 | Baird | <p>"During the quarter, the company sold 190,000 lines and had 135,000 net line installations to end the year with 1,015,000 lines in service. The company discovered line count discrepancies as it went through the process of reconciling databases and as a result, restated its previous lines in service downward by 125,000....</p> <p>...Management lowered its guidance for FY02 capital spending from the \$225 million to \$250 million range to \$215 million to \$240 million, which is well below the \$400 million allowed by its debt covenants. Management indicated approximately \$150 million to \$180 million of the FY02 budget is success-based capital driven by line growth...."</p> |

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|---------|------------------------------------|---|
| 2/20/02 | BB&T Capital Markets | <p>"After reconciling reporting elements within its back office, management has adjusted its line count downward by 125,000, ending the year with 1,015,000....</p> <p>...With respect to the reconciliation adjustment, we do not expect such an adjustment to take place again....</p> <p>...Lines installed are expected to grow by 600,000, versus our previous estimate of 625,000....</p> <p>...As a result of this reconciliation effort, management has adjusted its line count downward by 125,000. Specifically, while the company added 135,000 lines in the quarter, the net increase over the Q3/Q1 cumulative total of 1,005,900 amounted to only 9,100....</p> <p>...We are lowering our 2002 revenue estimate to \$800.1 million from \$814.7 million, due primarily to more modest expectations for line sales in 2002...."</p> |
| 2/20/02 | Bear Stearns Fixed Income Research | <p>"Quarterly revenue growth rebounded to 12.4% from 8.9% in 3Q01 following the impact of the events of September 11. In particular, revenue growth was driven by 134,100 new line installations for a year-end total line count of 1,140,000. At the end of 4Q01 the company reduced its reported line count by 125,000 to 1,015,000 (93% on-switch) in order to reconcile the external reporting methodology to internal accounting.</p> <p>... During 4Q01, lines sold rebounded to 190,000 lines, compared with 182,000 lines in 3Q01, while new lines installed declined by 1.5% sequentially to 134,100 due to a weaker backlog at the beginning of the quarter....</p> <p>In 2002, we estimate that Allegiance should generate 51.1% revenue growth, pushing revenues to \$781.2 million, while EBITDA losses should decline from \$(112.3) million to \$(22.3) million, driven by continued economies of scale as the company installs an estimated 575,000 lines...."</p> |
| 2/20/02 | CIBC World Markets | <p>"...and a 125K access line downward adjustment after a database reconciliation. While perhaps sloppy, we expect this to offer a conservative 'base line' for future growth.</p> <p>...</p> <p>On the positive side, the company did reaffirm its guidance for 2002, including \$800 million in revenue, driven by net line adds of 550-600,000, and its expectation to turn EBITDA positive sometime around late 3Q or early 4Q- clearly a significant milestone...."</p> |
| 2/20/02 | Deutsche Bank Alex. Brown | <p>"Switched voice revenue of \$88Mn accounted for 58% of total revenue and increased 3% sequentially. These results were weaker than our estimate (see above), largely due to the lower than expected number of net line installs.... Going forward, IAD sales are expected to exceed 50% of total line installs and will be reported as part of the data segment....</p> <p>Net line installs in the quarter declined on a sequential basis to approximately 135,000. We believe this flat performance is not a reflection of the company's back office processes or installation capacity, but rather a function of a high level of churn....</p> <p>Since 2Q01 the company has installed approximately 135K lines per quarter on a net basis. In the same period the company added four new markets. The company has guided to 600k net line adds by the end of 2002, implying 150k in net adds per quarter beginning in 1Q02....</p> <p>Interestingly, management revealed a revision to its number of installed access lines that arose from a database reconciliation project. As a result of this effort, the company has arrived at a consistent methodology for counting access lines across its disparate order management, billing and provisioning databases. Unfortunately, a side effect of this exercise is the discovery that the company needed to adjust downward its installed access line count by about 125,000 lines.</p> <p>...</p> <p>The company is projecting 600,000 net line adds in 2002...."</p> |

2/20/02 [1] Fitch Ratings

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|-------------|--|---|
| 2/20/02 [2] | Goldman Sachs Global High Yield Research | <p>"During the quarter, Allegiance reconciled (reduced) its line count by approximately 125,000, so it added only a net 9,100 lines. Approximately 33,000 of these lines were generating revenue in Allegiance's billing system, so approximately \$5 million in quarterly revenue was churned from the company's local service revenue, but it was offset by strong Integrated Access Device (IADs) revenue growth....</p> <p>...Management stated that integrated access and dedicated Internet services represent nearly 50% of all new lines added versus 40% last quarter and 22% in the second quarter....</p> <p>...Second, Allegiance conducted a reconciliation of access lines between its billing, provisioning, and its maintenance systems and identified approximately 125,000 lines that needed to be removed from line count. Of the total, we approximate 33,000 or \$5 million in quarterly revenue that needed to be removed from the billing system and impacted Allegiance's Local Voice revenue run rate. Because of the line true-up, Allegiance added a net 9,100 lines in the fourth quarter. On the conference call, management stated that a record 60,000 new lines were added in January; it noted that although reconciliation of databases would be ongoing in the future, the company does not expect to take any additional large corrections like this one. Because Allegiance reduced some 90,000 lines that were not in its billing database this quarter, ARPU increased to \$50 from \$48 per month...."</p> |
| 2/20/02 | Hibernia Southcoast Capital | <p>"Unfortunately, Bears will have additional fodder during 1Q02, as ALGX scrubbed their databases and found some differences in line count between billing and order management platforms. Consequently, management reduced the cumulative installed line base by approximately 125,000 lines to a new total of 1,015,000. The miscount is the result of (1) errors that were made in manual processing during the company's early stages, (2) differences in the definition of an 'access line,' with one platform counting DS-0s and another counting primarily voice lines, and (3) acquisitions. Importantly, the adjustment to cumulative lines installed had a minor impact on revenue (less than \$5 million), as the vast majority of the revisions was definitional rather than functional. Therefore, the company's average revenue per line mathematically increased with the lower line count. Approximately 30,000 of the miscounted lines were resale (low margin) and 95,000 were facilities based; a disproportionate share of the adjustment was in the company's nine oldest markets, causing a slight decline in the EBITDA margin in those markets from 28.2% to 27.8%. In light of 'Enron-it-is,' we believe an increasingly skeptical market will have a negative view of this adjustment....</p> <p>...Unfortunately, the line revision will cloud the company's otherwise strong performance....</p> <p>...Importantly, sales productivity improved from 114 lines per salesperson per quarter in 3Q01 to 119 in 4Q01. Our 2002 model is built on sales productivity of 118 lines per salesperson per quarter....</p> <p>...The company missed its EBITDA guidance by 4.4% and exceeded its line install target."</p> <p>"The churn effect was magnified by an accounting house cleaning undertaken in December and completed in February which resulted in a restated line count (explained in detail below) and a one-time charge of \$5.5 million impacting EBITDA.... We do not expect the restatement of the line count or the new line counting methodology to have a meaningful impact on our financial projections going forward, and are not making any major changes to our numbers for 2002....</p> |
| 2/20/02 | JP Morgan H&Q | |

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|---------|-----------------|---|
| 2/20/02 | Lehman Brothers | <p>At the end of the fourth quarter, Allegiance changed the way it counts and reports access lines, reducing the reported line count by 125,900 access lines to 1,015,000 total installed lines at year-end. This resulted in reported net installations for the quarter of 9,100 lines although the actual number of lines installed in the fourth quarter was 135,000, roughly the same as the third quarter. The 125,900 reduction in the line count was caused by two issues stemming from the results of an internal audit initiated by the CEO Royce Holland in December and completed approximately one week ago. First, in an effort to better coordinate its billing, provisioning and payables databases (previously each used different line count methodologies, only one of which was used to report lines to the Street), the company will now use a single line counting methodology, which reportedly undercounts data lines (we assume as single line connections) and therefore reduces the reported installed line base.</p> <p>Second, the company also removed some lines from its database that had been disconnected (or were lines that customers had asked to have disconnected) but were still being billed and counted. The contributory impact of these two factors individually is uncertain. The revenue related to these removed lines was stripped out from gross revenue in the quarter creating a \$3.5 million headwind for net reported revenue. While management has known about both line count issues and has been making adjustments to the financial statements on an ad hoc basis in the past, the company made the adjustment in the fourth quarter in order to provide a clean and coordinated assessment of its line and customer count and to set a single line counting an billing methodology going forward.</p> <p>...Allegiance's local revenue for the quarter of \$87.5 million was 5% lower than our projection due to continuing declines in access revenues, the revenue headwind from the restated line count and cancellations of orders that had been placed in the second or third quarter of 2001 but could not be provisioned due to the impact of the events of September 11.... In the month of January alone, Allegiance installed roughly 60,000 new IAD connections, roughly half of its total line installations for the month, which gives us confidence in the company's ability to scale the business and leverage its now complete 36 market network buildout....</p> <p>Most of the revenue impact related to the reduction in Allegiance's installed line base was evident in the company's financial performance at its early nine markets. Total revenue in these nine markets grew only 2% over the third quarter, compared to 12% sequential growth overall. We believe that this is due to the fact that most of the disconnected lines that were removed from the installed line base were resold lines, which are primarily located in Allegiance's older markets since the company does not offer resale any more...."</p> <p>"In aggregate, absolute revenue growth improved 4-fold to nearly \$20M off 3Q01's trough, adjusting for contra-revenues, acquisition, and line reconciliation impacts....</p> <p>Following a 6.9% 3Q01 contraction overall ARPUs rebounded 4.3% on a reported basis, as the database reconciliation of 125,000 lines favorably impacted this metric. Assuming this line reconciliation reflects a net of acquisition figure, reversing the reconciliation, by our estimates, suggests steadier pricing trends, with overall ARPUs increasing 0.7% to \$48.37, on adjusted basis, still an impressive performance in a typically seasonality impacted 4Q and with minimal contribution from late-3Q installs.</p> <p>...Adjusted for the database reconciliation and purchases, installs came in flat with 3Q01 at 135,000 lines, amidst a 'stale' 3Q01 backlog and associated higher cancellation rates. Higher-end IAD/bundled lines accounted for roughly half of the installs compared with 22% in 2Q01 and 40% in 3Q01. With estimated monthly churn below 0.5%, management hopes to increase this share to 60% by YE02. The company also added 17 collocations in 4Q01, relative to 32 in 3Q01 and 50-80 quarterly for 1Q00 through 2Q01 and signaled a potential respite in its addressable market aspirations. On a per collo basis, installs per day continue to steadily abate, contracting 1% sequentially and 8% since 1Q01 to 2.84 per day in 4Q01. Versus 91% in 3Q01, on-net facilities accounted for 93% of installed lines, due to reconciliation of 30,000 resale units amidst the 125,000 total line adjustment.</p> |

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|------------------------|----------------------|--|
| 2/20/02 | McDonald Investments | <p>Following the challenging 3Q01 environment, lines sold returned to 2Q01 levels of 192,000, although productivity per effective rep remains below 2Q01's level of 49.4 lines at 43.0 lines, a slight improvement over 3Q01, by our estimates. Our 207,600 sales forecast and 149,300 net install estimate called for a more robust productivity environment.</p> <p>... Significant Line Adjustment. ALGX adjusted its YE01 line balance down by roughly 14%, citing its outsourced billing platform as the primary cause for the discrepancy. Key components of the adjustment include 125,000 lines (30,000 resale, 95,000 UNE) that had been misreported in prior periods and roughly 15,000 lines from the acquired Coast-to-Coast operations, which had not been included in the ending 3Q01 line count.</p> <p>In association with this line adjustment, the reported revenue in the period was approximately \$5M lower as the company had, in prior periods, continued to bill customers that had churned off / canceled service with ALGX, potentially overstating previously reported revenues. The misreported revenues have likely been contributors to the escalating bad debt at the company, and with this issue addressed, hopefully can improve on this metric going forward. While an adjustment to reported lines is not uncommon in the industry, the magnitude of this restatement raises some concerns about the strength of the company's much trumpeted back office operations and how conservative, versus necessary, the company's bad debt reserves have been. Hopefully the company has corrected the outstanding problems and, by bringing the billing systems in house, can avoid such problems in the future.*</p> <p>*Reconciliation project reduces line count by 125,000.</p> <p>...As part of the reconciliation process, the Company's access line count was adjusted downward by 125,000 to 1,015,000 lines in service. While purely from an operational perspective we are not alarmed by this adjustment, given the state of the market, such a revision could be viewed negatively in the post-Enron/Global Crossing era as some sort of an accounting issue....</p> <p>...Lines in service continued to improve from 425,380 in 1Q01 to 538,112 during the quarter, while the Company's gross margin increased from 59% to 61.5% over the same time frame....</p> <p>...Additionally during the year, the Company projects to install 600,000 access lines, activate SONET fiber networks in two new markets, add 61 collocations, and incur \$215 million-\$240 million in capital expenditures....</p> <p>...In addition, we reiterate that while the line count reconciliation is a back office issue and not an accounting issue, we believe that this adjustment could nonetheless rattle some investors in the near-term given the intense scrutiny being placed on such matters.*</p> <p>*The line-reconciliation project and one-time charges blur an assessment of the company's operations.</p> <p>... Allegiance's 4Q01 results fell short of expectations. Revenues totaled \$151.8 million vs. our \$155.3 million estimate, on approximately 135,000 new lines installed (10,000 fewer than our estimate).... Management attributes weak 4Q01 installs to a reduced unprovisioned line backlog from the events of September 11; however, we believe slowing mature-market revenue and line growth is contributing to subpar overall performance.</p> <p>...Allegiance reported that lines installed in its nine mature markets increased during 4Q01 by 7.9% (adjusted for line reconciliation) to over 538,000 lines, and representing an estimated 9.1% revenue increase; the 4Q01 mature market penetration rate was 5.9%....</p> <p>...Allegiance reconciled its order management and billing systems resulting in fewer actual lines installed by approximately 125,000 as of year-end 2001 than it had previously been reporting. The adjustment had just under a \$5 million impact on revenues.</p> <p>...We have reduced our 2002 revenue estimate to \$800 million from \$812 million, on a 600,000 line-installation estimate during the year...."</p> |
| 2/20/02 ^[B] | RBC Capital Markets | |

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | | Analyst | | Commentary on Line-Counts |
|---------------|--|---|--|---|
| 2/20/02 | | Robertson Stephens | | "Allegiance reported 135,000 net line additions in Q4, before adjusting for a one-time line reconciliation. The company ended the year with 1.0 million lines in service, after eliminating 125,000 lines from a database reconciliation. The line reconciliation did not have a material impact on revenues and does not have a material impact on projections. We project 602,000 net line additions in 2002 (in line with guidance), driven by an increasing component of IAD sales in the mix. In January, the company completed a record 60,000 line installations. Allegiance has improved its provisioning of IAD lines, allowing it to address customers with 6+ lines versus the previous 8+ line limit, which we expect will accelerate line growth and drive higher quality, higher margin revenues." |
| 2/20/02 [213] | | Salomon Smith Barney Corporate Bond Research | | "Operationally, ALGX sold 190,000 access lines in the quarter, up from 182,000 in the third quarter. Total access lines sold grew to 1,573,300, a 12.1% sequential increase from 1,383,300 at the end of the third quarter of 2001. Internally, ALGX installed 135,000 access lines in the quarter. However, due to a downward access line adjustment of 125,000, total access lines installed at the end of the quarter totaled 1,015,000 from 1,005,800...." |
| 2/20/02 [4] | | Stephens Inc. | | "[W]e continue to look with skepticism on Allegiance's use of the 'line equivalent' concept, by which telephone companies have portrayed each 64 kilobits of transmission capacity provided to a customer as 'equivalent' to one voice circuit, regardless of how the bandwidth is sold or used. In a <i>Research Bulletin</i> published October 24, 2001, after it released third-quarter earnings and operating data, we wrote: 'We will no longer value Allegiance's shares on an access line equivalent basis because we think those numbers are losing their relevance.' As if to confirm our doubts, the carrier announced yesterday that it would reduce by about 12% its claimed 'line equivalents' served, explaining that inconsistent billing records had inflated its prior count by 125,000 voice 'equivalents.'" |
| 2/20/02 | | Thomas Wiesel Partners | | "Lines installed were 135,000 versus our 145,000 estimate. ...We still believe management is being conservative with respect to 2002 numbers, as the expected increase in IAD lines as a percent of total implies lower progressive churn rates throughout 2002. ...Management reiterated guidance for FY02 of approximately \$800 million in revenue and 600,000 lines installed. Allegiance ended Q4 with 1,015,000 lines installed (including a reduction of over 125,000 lines as a result...between billing and provisioning data bases). Despite sequential growth in line sales in Q4 (from 182,000 to 190,000), installs quarter to quarter remained flat mainly as a result of a weaker-than-expected October. However, install activity has apparently picked up as the company indicated that gross installs in January for just the LAD and UNE based lines, was over 60,000, its highest monthly level yet. Importantly, over 50% of lines installed during the quarter were LAD sales, a combination of multiple voice lines and a dedicated data line in one package, which should help reduce churn in 2002. ...The reconciliation of lines between databases was unexpected, and while it probably does mean some lower level of expense in 2002, and doesn't really impact 2002's revenue ramp (ARPU was artificially low as a result in the nine months prior), it also raises questions...." |
| 2/20/02 [319] | | UBS Warburg | | — |

Exhibit 5

Analyst Reports: Line Count References

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Commentary on Line-Counts |
|---------|--------------------------|---|
| 2/20/02 | UBS Warburg | <p>"IADs represented about 50% of lines provisioned during the quarter, up from 40% in 3Q01. Management anticipates that IAD will represent about 60% of installations by the end of 2002. Allegiance reported 60,000 IAD orders in January, a record number.</p> <p>...Management noted that its IAD provisioning factory had achieved sufficient scale and efficiencies to lower the minimum line count for IAD from 8 to 6 lines, enabling Allegiance to sell to many more smaller businesses....</p> <p>Due to a database audit, Allegiance eliminated \$5 million in local revenue. We discuss this further below. Thus, we compare corrected 3Q01 local revenue of \$80.4 million to 4Q01 local revenue of \$87.5 to derive a 9% growth rate, slightly below our 12% growth expectations. This \$5 million elimination is a one-line event. The audit led to elimination of 125,000 lines from its total line counts. Thus, since IAD lines tend to carry lower revenue per line, ARPU fell to \$50 during the fourth quarter from an adjusted \$51.50 in the third quarter (ALGX reported \$48 ARPU including the 125,000 lines).</p> <p>Reclassifying Lines in Service. Allegiance undertook a database reconciliation project that resulted in the reduction of its line count by 125,000 lines. The project adjusted for synchronization and data entry errors between the provisioning and billing systems. Since most errors were contained in the provisioning system, not the billing system, the impact of revenue was immaterial. The adjustment included 95,000 facilities-based lines and 30,000 resold lines. Thus, Allegiance ended the fourth quarter with 1,015,000 lines in service. Lines sold increased from 182,000 in the third quarter to 190,000 lines, an increase of 4.4 percent, and 1% above our expectations. Lines installed were down slightly from 136,200 in the third quarter to 135,000 in the fourth quarter."</p> |
| 2/20/02 | US Bancorp Piper Jaffray | |

Note:

- [1] Analyst report covering Allegiance Telecom, Inc. credit rating.
- [2] Analyst report covering Allegiance Telecom, Inc. bonds.
- [3] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.
- [4] "Over time, we expect the 'access line equivalent' statistics reported by Allegiance will become less and less meaningful as the IAD program drives up the proportion of traffic comprised of data rather than voice. The value of customers, and the revenue streams attached to them, as opposed to 'lines' in service and 'revenue per line,' will increasingly drive investor understanding of the Company and its shares. In our view," (Stephens, Inc. Analyst Report dated 10/24/01)
- [5] Analyst report is a telecom sector overview not specific to Allegiance Telecom, Inc.

Exhibit 6

Analyst Reports: Projected Performance

2/19/02 – 2/20/02

Source Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | | Analyst | Projected Performance |
|---------|--|------------------------------------|--|
| 2/19/02 | | Bear Stearns | |
| 2/19/02 | | Credit Suisse First Boston | <p>"We are publishing our new 2002 quarterly estimates. In addition, we are lowering our '02 total revenue forecast by 3% to \$769.6M to reflect a slower than previously forecast ramp in local revenues, particularly in light of the 4Q local revenue shortfall, somewhat offset by a faster expected ramp in data revenues to reflect the 4Q out performance in this category. Revenue revisions are as follows: 1) lowering local services revenues by 20% to \$416.7M, now a 28% y/y increase; 2) raising data revenues by 44% to \$301.1 M, now a 87% y/y increase; and 3) lowering LD revenues by 5% to \$51.7M, primarily as a result of the shortfall vs. our 4Q estimate, now a 75% y/y increase. We note that our '02 revenue forecast excludes any impact from the acquisition of IBI assets, which we estimate could contribute up to an additional \$30M during the year.... We are widening our '02 EBITDA loss estimate by \$4.3M to a loss of \$35.2M to reflect the revenue reduction as well as our forecast that the company will continue improving both gross and SG&A margins during '02 over the level we saw during 4Q01. We forecast that ALGX will turn EBITDA positive during 4Q01...."</p> |
| 2/19/02 | | Salomon Smith Barney | <p>"ALGX gave quarterly revenue guidance as follows: \$165-168 million, \$185-190 million, \$208-213 million and \$232-237 million for 1Q'02, 2Q'02, 3Q'02 and 4Q'02, respectively. We do note, however, that the sum of the low end of the ranges totals \$790 million versus its guidance of \$800 million. To be conservative, we are maintaining our \$780 million 2002 revenue estimate, which is consistent with our overall view of the industry in the near-term...."</p> |
| 2/20/02 | | Baird | <p>"We have reduced our FY02 revenue estimate by \$15 million to \$785 million on an \$85 million reduction in local service revenue, partially offset by a \$70 million increase in data services revenue. We are leaving our FY02 EBITDA loss estimate unchanged at \$20 million. We have increased our FY02 loss per share to \$3.75 from \$3.56 on higher depreciation expense based on the higher-than-expected run-rate exiting Q4."</p> |
| 2/20/02 | | BB&T Capital Markets | <p>"We are lowering our 2002 revenue estimate to \$800.1 million from \$814.7 million, due primarily to more modest expectations for line sales in 2002...."</p> |
| 2/20/02 | | Bear Stearns Fixed Income Research | <p>"In 2002, we estimate that Allegiance should generate 51.1% revenue growth, pushing revenues to \$781.2 million, while EBITDA losses should decline from \$(112.3) million to \$(22.3) million, driven by continued economies of scale as the company installs an estimated 575,000 lines.... We anticipate continued incremental improvement in operational profitability during 2002, and expect the company to reach EBITDA breakeven in 4Q02. Our estimates are at or below the company's back-end-loaded guidance levels, reflecting our conservative view of the company's ability to significantly increase gross line installations, reduce churn and establish economies of scale as rapidly as forecast."</p> |
| 2/20/02 | | CIBC World Markets | <p>"On the positive side, the company did reaffirm its guidance for 2002, including \$800 million in revenue, driven by net line adds of 550-600,000, and its expectation to turn EBITDA positive sometime around late 3Q or early 4Q - clearly a significant milestone.... Below, we outline company guidance for 2002, as well as the covenants on its revolver and our estimates."</p> |

Exhibit 6

Analyst Reports: Projected Performance

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| | | Projected Performance | |
|------------------------|-----------------------------|---|--|
| Date | Analyst | | |
| 2/20/02 | Deutsche Bank Alex. Brown | "Our est.'s for FY02 reflect our cautious outlook for the economy the rest of emerging telecom - \$774Mn in rev and an EBITDA loss of \$29Mn, adjusted slightly from our previous rev and EBITDA estimate of \$770Mn and a loss of \$28Mn respectively." | |
| 2/20/02 ^[1] | Fitch Ratings | "A major factor that led to the bankruptcy filings and recapitalizations of many of ALGX's competitors was their inability to meet bank covenants. To date, ALGX has not been in danger of violating any of its covenants. Its most stringent covenant in 2002 is its quarterly revenue covenant, requiring \$755 million in revenue for 2002 (\$155 million 1Q'02; \$180 million 2Q'02; \$200 million 3Q'02; \$220 million 4Q'02). The current public forecast is \$800 million, and Fitch believes if demand for IAD remains strong and the company is able to continue to successfully provision the service, it will satisfy its revenue covenant." | |
| 2/20/02 ^[2] | Goldman Sachs | "On the conference call, management released guidance for 2002. We estimate that the company will generate \$785.6 million in revenue and an EBITDA loss of \$12.3 million. All of our quarterly revenue estimates are ahead of Allegiance's bank debt covenants as well, but the company is within \$5-10 million of its covenants each quarter, so there is minimal room for management to bring its guidance down without creating a concern. We forecast that Allegiance will reach EBITDA positive during the second half of 2002...." | |
| 2/20/02 | Hibernia Southcoast Capital | "We are tweaking our estimates to reflect the company's more detailed guidance. We are lowering our 2002 EBITDA estimate to \$(3.9) million from \$4.5 million...." | |
| 2/20/02 | JP Morgan H&Q | "Our first quarter revenue estimate stands at \$168 million, at the high end of the management's guidance range. ...For 2002, we have set our EBITDA estimate at a loss of \$19.4 million and with out first quarter EBITDA estimate being a loss of \$17 million. We expect the company's operations to turn EBITDA positive some time in the third quarter of 2002, although we expect the fourth quarter to be the first full quarter of positive EBITDA." | |
| 2/20/02 | Lehman Brothers | "Lowering our 2002 organic revenue estimate \$10M to \$773M and widening our EBITDA loss to \$17M versus guidance of \$790M-\$808M and \$15M-\$25M respectively." | |
| 2/20/02 | McDonald Investments | "For 2002, we now expect ALGX to produce \$775 million in revenues, \$(29) million in EBITDA, and \$(3.72) in EPS. Previously, we had projected the Company to generate 2002 revenues of \$789.1 million, EBITDA of \$(45.4) million, and EPS of \$(3.63)." | |
| 2/20/02 ^[3] | RBC Capital Markets | "We have reduced our 2002 revenue estimate to \$800 million from \$812 million, on a 600,000 line-installation estimate during the year.... Our EBITDA loss estimate is \$20.9 million, with projected EBITDA breakeven in 4Q02; however, this is one quarter later than we had previously modeled...." | |
| 2/20/02 | Robertson Stephens | "We have lowered our 2002 revenue estimate to \$771 million from \$803 million, driven by (1) a carry-over from the 2001 impact on backlog/provisioning caused by the events of September 11; (2) the weak economy; and (3) the previously announced move away from dedicated hosting. We have also increased the EBITDA loss to \$(24) million from \$(10) million. Our numbers do not include the positive impact of the IBI acquisition." | |

Exhibit 6

Analyst Reports: Projected Performance

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst | Projected Performance |
|-----------------|--------------------------|---|
| 2/20/02 [2],[3] | Salomon Smith Barney | "In this respect, ALGX remains committed to continue growth, reaffirming its revenue guidance of \$800 million for 2002 and becoming EBITDA positive in the second half of this year...." |
| 2/20/02 | Stephens Inc. | "We have adjusted our projections for Allegiance's latest guidance. For 2002, we forecast revenue of just under \$800 million and EBITDA of (\$22 million). For the first quarter, we forecast revenue of \$166 million and EBITDA of (\$19.9 million)." |
| 2/20/02 | Thomas Weisel Partners | "We are maintaining our 2002 estimates for revenue of \$825.0mn (+58.9% y-y) and EBITDA of \$1.7mn. Our current revenue estimate is above the high end of management's range (\$810mn) for 2002, as is EBITDA, and reflects expectations of an improved business environment in 2H02. Management is indicating that it will have more clarity on the expected revenue contribution from the recently acquired IBI assets by 2Q02...." |
| 2/20/02 [2],[4] | UBS Warburg | "The company's new 2002 guidance reflects our cautious view toward the business in the raging telecom storm. The company's 2002 revenue guidance of \$790-\$808 million is in line with ALGX's earlier \$800 million forecast and our \$785 million estimate. The CLEC's projected 2002 EBITDA loss is now between \$15-\$25 million with breakeven expected in late 3Q01/early 4Q01. This compares to our estimate of a \$21 EBITDA loss and is below previous guidance of a \$10 million loss for 2002...." |
| 2/20/02 | UBS Warburg | "2002 revenue guidance of \$790-\$808 million is in line with ALGX's earlier \$800 million expectation and our \$785 million estimate. The CLEC's projected 2002 EBITDA loss is now between \$15-\$25 million with breakeven in late in the third or early in the fourth quarter. This compares to our estimate of a \$21 EBITDA loss and is below previous guidance of a \$10 million loss for 2002. |
| 2/20/02 | US Bancorp Piper Jaffray | ... We expect this [the IBI] acquisition will benefit ALGX's cost structure rather than be a significant revenue driver...." "2002 estimates are unchanged. We are maintaining our estimates for 2002 at \$800 million in revenue, (\$16.9) million in EBITDA, and \$225 million in capital expenditures. We continue to be confident that Allegiance can attain these estimates without an improvement in the macroeconomic environment. This will be done by the Company continuing to take market share from the incumbent telephony providers." |

Note:

- [1] Analyst report covering Allegiance Telecom, Inc. credit rating.
- [2] Analyst report covering Allegiance Telecom, Inc. bonds.
- [3] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.
- [4] Analyst report is a telecom sector overview not specific to Allegiance Telecom, Inc.

Exhibit 7

Equity Analyst Reports: Breakdown of Valuation Methods

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst ^[1] | Valuation Method Used | | | | | EV/ | |
|-------------------------------|-----------------------------|-----------------------|-----------------------|----------------------------|--|--|-------------------------------|---|
| | | DCF | EBITDA ^[2] | EV/ Revenue ^[2] | Last Quarter Annualized Revenue ^[2] | Property, Plant, & Equipment Multiple ^[2] | EV/ Line Count ^[2] | |
| 2/19/02 | Bear Stearns | - | - | - | - | - | - | - |
| 2/19/02 | Credit Suisse First Boston | - | - | - | - | - | - | - |
| 2/19/02 | Salomon Smith Barney | 1 | - | - | - | - | - | - |
| 2/20/02 | Baird | 1 | 1 | - | - | - | - | - |
| 2/20/02 | BB&T Capital Markets | 1 | - | - | 1 | 1 | - | - |
| 2/20/02 | CIBC World Markets | - | - | - | - | - | - | - |
| 2/20/02 | Deutsche Bank Alex. Brown | 1 | - | - | - | - | - | - |
| 2/20/02 | Hibernia Southcoast Capital | - | 1 | - | - | - | - | - |
| 2/20/02 | JP Morgan H&Q | - | - | - | - | - | - | - |
| 2/20/02 | Lehman Brothers | - | - | - | - | - | - | - |
| 2/20/02 | McDonald Investments | - | - | 1 | - | - | - | - |
| 2/20/02 ^[3] | RBC Capital Markets | - | - | 1 | - | - | - | - |
| 2/20/02 | Robertson Stephens | 1 | - | - | - | - | - | - |
| 2/20/02 | Stephens Inc. | 1 | - | - | - | - | - | - |
| 2/20/02 | Thomas Weisel Partners | - | - | - | - | - | - | - |
| 2/20/02 ^[4] | UBS Warburg | - | 1 | - | - | - | - | - |
| 2/20/02 | US Bancorp Piper Jaffray | 1 | - | - | - | - | - | - |
| Total: | | 7 | 3 | 2 | 1 | 1 | 0 | |
| Percent^[5]: | | 64% | 27% | 18% | 9% | 9% | 0% | |

Note:

[1] There were six additional reports provided by Preston that were covering either Allegiance Telecom, Inc. bonds, credit ratings, or were not specific to Allegiance that are not included in this analysis.

[2] Analyst typically calculate Enterprise Value (EV) as the sum of market value plus net debt.

[3] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.

[4] There were two 2/20/02 UBS analyst reports provided by Preston. One is a telecom sector overview not specific to Allegiance Telecom, Inc which is not included in this analysis, but does utilize the same valuation methodology.

[5] Calculated as number of times the valuation method is used over the number of equity analysts reporting valuation methodologies.

Exhibit 8

Analyst Reports: Commentary on Valuation

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst ⁽¹⁾ | Valuation Comments |
|------------------------|-----------------------------|--|
| 2/19/02 | Salomon Smith Barney | "We are also lowering our price target from \$10 to \$6, which is based on our new 10-year DCF model using about an 18% discount rate and an 8x terminal multiple. The new DCF uses a higher discount rate that reflects a higher beta of almost 1.7 versus the previous beta of 1.3 (Bloomberg adjusted betas)...." |
| 2/20/02 | Baird | "Allegiance is trading at 2.0x FY01 revenue and 1.3x our FY02 revenue estimate compared to its closest peer Time Warner Telecom (TWC - \$6.51) at 1.9 x and 1.7x, respectively.... We are reducing our price target to \$8, which is based on 15x our preliminary thoughts of \$115 million in FY03 EBITDA." |
| 2/20/02 | BB&T Capital Markets | "...Shares of ALGX are currently trading at 1.8x Q4'01 annualized revenues of \$607 million and 1.3x estimated 2002 revenues of \$800.1 million...." DCF included as exhibit to BB&T's report. |
| 2/20/02 | Deutsche Bank Alex. Brown | "...our new 12 month DCF derived target which falls from \$9 to \$7 target...." |
| 2/20/02 | Hibernia Southcoast Capital | "Our current model shows the company selling for 9.2x 2003E EBITDA...." Price target of \$24 with no indicated change. |
| 2/20/02 ⁽²⁾ | RBC Capital Markets | "We are lowering our 12-month price target to \$5 per share (from \$8), primarily due to the change in revenue as well as a lower revenue target multiple that is now in line with the peer group's 1.5x EV/2002 revenue estimate multiple." |
| 2/20/02 | Robertson Stephens | "We are reiterating our Strong Buy rating with a 12-month price target of \$13 per share (down from \$17). Our price target is based on our DCF model, which implies a 2003E EV/EBITDA multiple of 14.8x for a company with a five-year revenue CAGR of 25%." |

Exhibit 8

Analyst Reports: Commentary on Valuation

2/19/02 – 2/20/02

Source: Analyst reports provided by Candace Preston in her Second Report dated 10/31/07

| Date | Analyst ^[1] | Valuation Comments |
|---------------------------------------|--------------------------|--|
| 2/20/02 | Stephens Inc. | "We have reduced our one-year target price to \$13 per share from our prior target of \$16.... In any case, we value Allegiance using a Discounted Cash Flow model. We have raised the discount rate in our model from 18% to 20%, in response to the slight softening of Allegiance's outlook and the marked softening of telecom investor sentiment toward the CLEC sector...." |
| 2/20/02 ^[3] ^[4] | UBS Warburg | "We maintain our...\$5 price target based on our 8.5 multiple of 2003E EBITDA." |
| 2/20/02 | UBS Warburg | "...\$5 price target based on 8.5 multiple our 2003E EBITDA." |
| 2/20/02 | US Bancorp Piper Jaffray | "Our five-year DCF Model estimates the stock is worth \$17 per share over the next 12 months. We estimate a five-year revenue CAGR of 44%, EBITDA margins average (1.7%) over that five-year term, but positive in 2003, and capital expenditures greater than EBITDA until 2005. We used a weighted-average cost of capital of 10.1%." |

Note:

- [1] Only analyst reports that discussed their valuation methods are included.
- [2] Analyst report provided with 10/31/07 report, but not mentioned by Ms. Preston within the report.
- [3] Analyst report covering Allegiance Telecom, Inc. bonds.
- [4] Analyst report is a telecom sector overview not specific to Allegiance Telecom, Inc.

Exhibit 9

Impact on Target Price of Increasing the Discount Rate in BB&T's DCF Model

Source: BB&T Capital Markets analyst report dated 2/20/02

| | (terminal multiple) | | | |
|-----|---------------------|---------|---------|-----------------------------------|
| | 9.0x | 10.0x | 11.0x | |
| 23% | \$7.40 | \$8.30 | \$9.20 | Average drop in target price 30%. |
| 20% | \$10.60 | \$11.80 | \$12.90 | |
| 17% | \$14.80 | \$16.30 | \$17.70 | Average drop in target price 28%. |

↑
(discount rate)

Exhibit 10

Allegiance Telecom, Inc.

Intraday Stock Price and Cumulative Volume

2/19/02

Source: TAQ ; CRSP

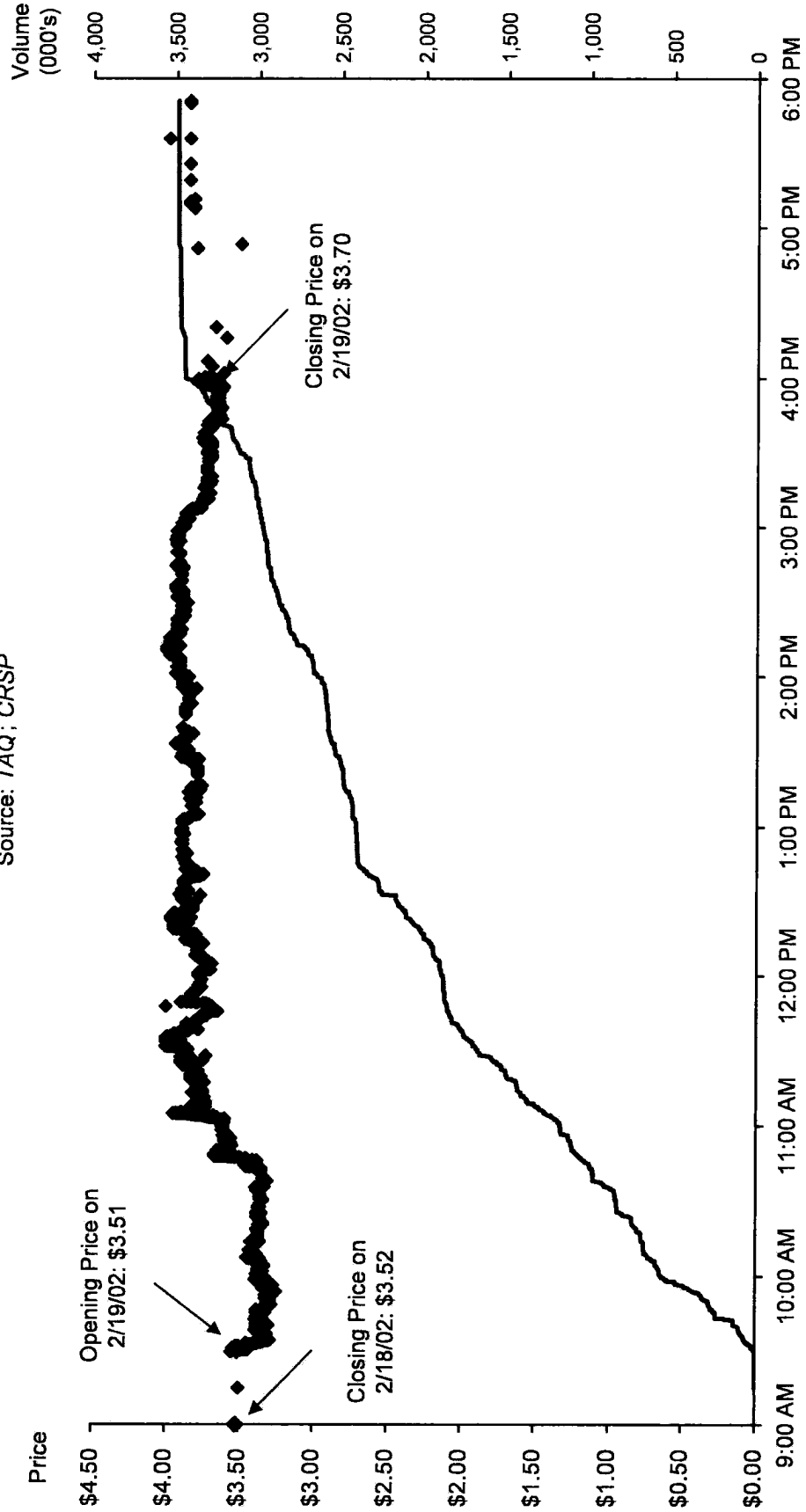
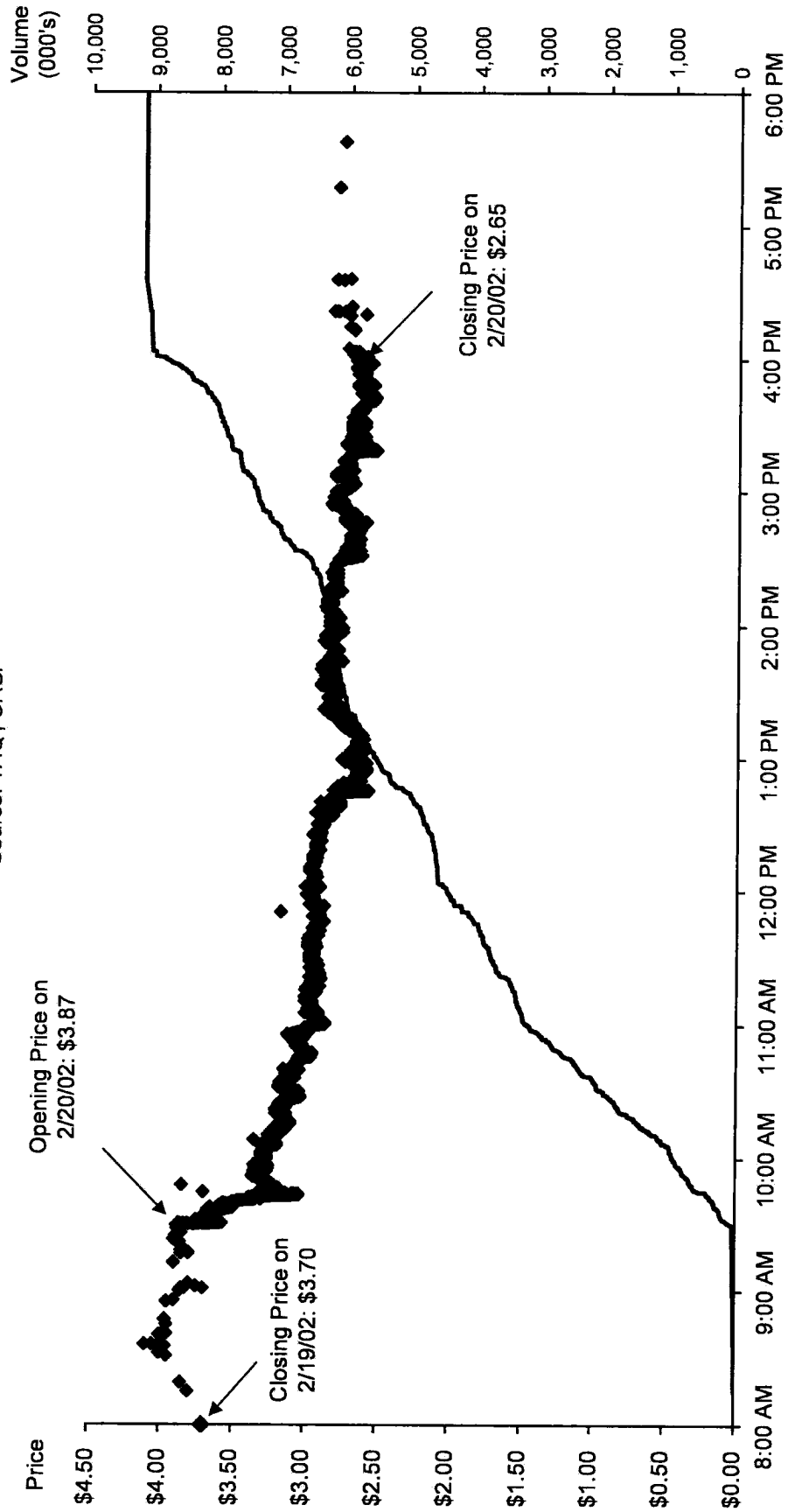


Exhibit 10 continued **Allegiance Telecom, Inc.** **Intraday Stock Price and Cumulative Volume**

2/20/02

Source: TAQ; CRSP



- iii. All of the analysts that provided a valuation methodology used either DCF or a multiple of EBITDA or revenues in their valuations
- iv. The changes in projections and discount rates (reflecting the riskiness of the future earnings and the risk of not meeting their covenants) accounted for most, if not all, of the decline in market value of Allegiance.
- d) The change in stock price on February 20 is inconsistent with Preston's opinion that the line count reconciliation released the previous day was instrumental in the price decline; it is consistent with the re-evaluation of information by the marketplace over that day regarding the future earning power and riskiness of Allegiance and revaluing the stock downward.



James K. Malernee, Jr.
December 3, 2007